

Message Text

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ACTION EUR-12

INFO OCT-01 EA-10 ISO-00 AID-05 CIAE-00 COME-00 EB-08
FRB-03 INR-10 NSAE-00 ICA-11 XMB-02 OPIC-03 SP-02
LAB-04 SIL-01 OMB-01 SS-15 STR-07 CEA-01 PA-01
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R 211802Z JUN 78
FM AMEMBASSY BONN
TO SECSTATE WASHDC 9605
DEPARTMENT TREASURY
WHITE HOUSE WASHDC
AMEMBASSY BRUSSELS
AMEMBASSY LONDON
AMEMBASSY PARIS
AMEMBASSY ROME
AMEMBASSY TOKYO

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USEEC AND USOECD ALSO FOR EMBASSIES

E.O. 11652: N/A
TAGS: ECON EFIN GW
SUBJECT: COUNCIL OF ECONOMIC EXPERTS AND FDP COME
OUT FOR ECONOMIC STIMULATION VIA TAX POLICY

REF: BONN 11032

1. SUMMARY: A SPECIAL REPORT OF FRG COUNCIL OF ECONOMIC
EXPERTS RELEASED ON JUNE 21 CALLS FOR EXTENSIVE CHANGES
IN TAX SYSTEM -- TO INCLUDE ALTERATIONS IN THE
PROGRESSIVITY OF THE PERSONAL INCOME TAX SYSTEM AS WELL
AS A LOWERING OF TAXES WHICH INHIBIT INVESTMENT AND A
RAISING OF INDIRECT TAXES -- AS A MEANS TOWARD HIGHER
ECONOMIC GROWTH. THE COUNCIL ALSO RECOMMENDS THAT THE
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PACE OF PUBLIC SECTOR EXPENDITURES -
BE CHECKED AND THAT THE
GOVERNMENT PROMOTE RISKY INVESTMENTS BY MEANS OF TAX
INCENTIVES. THE JUNIOR PARTNER OF THE GOVERNMENT
COALITION, THE FDP, ADOPTED ON JUNE 20 A PARTY PLATFORM
FOR TAX REDUCTIONS ANALOGOUS IN MANY RESPECTS TO THE
COUNCIL'S RECOMMENDATIONS. THEY WILL GET A COOL

RECEPTION FROM FDP'S COALITION PARTNER (SPD) WHICH
GENERALLY PREFERS ECONOMIC STIMULATION VIA EXPENDITURE
POLICY. END SUMMARY.

2. THE GOVERNMENT-APPOINTED (BUT NOT GOVERNMENT.
CONTROLLED) COUNCIL OF ECONOMIC EXPERTS RELEASED ON
JUNE 21 A SPECIAL REPORT ON THE ECONOMIC SITUATION
WHICH RECOMMENDS A COMBINED PROGRAM OF INCOME AND TRADE
TAX REDUCTIONS AND THE RAISING OF CONSUMPTION TAXES
AND/OR REDUCTION OF GOVERNMENT SPENDING PLANS. THE
RATIONALE OF THE PROPOSED CHANGES IS TO GIVE THE
PRIVATE SECTOR A GREATER INCENTIVE TO INVEST IN THE
MEDIUM AND LONG-TERM RATHER THAN TO BOOST SHORT-TERM
ECONOMIC GROWTH THE OUTLOOK FOR WHICH THE COUNCIL BELIEVES
REMAINS RATHER GUARDEDLY OPTIMISTIC.

3. THE COUNCIL RECOMMENDS THAT (1) THE GEWERBESTEUER --
A BUSINESS TAX BASED ON A COMBINATION OF PROFITS, CAPITAL,
AND PAYROLLS -- BE REDUCED OR, ALTERNATIVELY,
DEPRECIATION ALLOWANCES BE EXPANDED; (2) THE PROGRESSIVITY
OF THE PERSONAL INCOME TAX BE MITIGATED IN TANDEM WITH
A REDUCTION IN TAX PAYMENTS FOR MOST TAXPAYERS; AND
(3) TAX INCENTIVES FOR RESEARCH AND DEVELOPMENT,
PARTICULARLY FOR SMALL AND MEDIUM-SIZED BUSINESSES.
THE RESULTING REVENUE LOSSES WOULD BE PARTIALLY OFFSET
BY A RAISING OF INDIRECT TAXES -- ESPECIALLY THE VALUE
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ADDED TAX; AND A SLOWER PACE OF GOVERNMENT EXPENDITURE
INCREASES.

4. THE REPORT MAKES QUANTITATIVE SUGGESTIONS ONLY WITH
RESPECT TO REFORMING THE PERSONAL INCOME TAX STRUCTURE.
IT SUGGESTS THAT THE TAX BURDEN BE REDUCED
BY DM 14-20 BILLION PER YEAR. (NOTE: IN MOST
PROPOSALS THIS WOULD BE ACCOMPLISHED BY LOWERING THE
STARTING RATE FROM THE CURRENT 22 PERCENT LEVEL AND BY
SWINGING THE MARGINAL RATE STRUCTURE DOWNWARD FOR
MIDDLE INCOME BRACKET TAXPAYERS. PROGRESSIVITY WOULD
ACCELERATE FOR HIGHER INCOME BRACKETS AS THE MARGINAL
TAX MOVES TOWARD A TOP RATE OF 56 PERCENT.) THE
GEWERBESTEUER, WHICH IS APPLIED AT THE LOCAL
LEVEL AND VARIES BETWEEN COMMUNITIES, PROVIDED REVENUES
OF ABOUT DM 26 BILLION IN 1977. A (FOR EXAMPLE) ONE
PERCENTAGE POINT RISE IN THE VALUE ADDED TAX WOULD
PROBABLY PROVIDE ABOUT DM 5.5 BILLION IN INCREASED
REVENUES.

5. THE THRUST OF THE REPORT IS TOWARD STIMULATION OF
THE ECONOMY BY EASING TAX DISINCENTIVES ON ENTERPRISE

AND WORK RATHER THAN BY THE STIMULATION OF DEMAND.
THE COUNCIL REJECTS THE PROPOSITION THAT LARGER
BUDGETARY DEFICITS WOULD STIMULATE GROWTH AND ADDS THAT
THEIR FINANCING WOULD INCREASE PRESSURE ON CREDIT MARKETS

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THE REPORT'S ANALYSIS OF THE ECONOMIC SITUATION
REFUTES THE VIEW THAT THE FRG'S ECONOMIC PROBLEMS
ARISE FROM ANY DEFICIENCY OF DEMAND; IT INSTEAD
EMPHASIZES SUPPLY CONSTRAINTS.

6. CERTAINLY NOT BY COINCIDENCE, THE FDP PARLIAMENT-
ARY CONFERENCE CAME OUT ON JUNE 21 FOR A PROGRAM OF TAX
AND EXPENDITURE CHANGES WHICH IN CERTAIN RESPECTS
PARALLELS SOME OF THE COUNCIL'S RECOMMENDATIONS AND
WHICH EMPHASIZES STRUCTURAL (AS OPPOSED TO CYCLICAL)
IMPEDIMENTS TO ECONOMIC EXPANSION. ACCORDING TO PRESS
REPORTS, THE FDP PROGRAM CALLS FOR INCOME TAX REFORM
AND REDUCTION OF THE TRADE TAX IN 1979. IT, IN ADDITION,

PROVIDES FOR AN INCREASE IN CHILDREN'S ALLOWANCES.
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THE TOTAL COST OF THIS PROGRAM COULD AMOUNT TO AS MUCH
AS DM 20-23 BILLION A YEAR. A PART WOULD BE
RECOVERED THROUGH A ONE PERCENTAGE POINT INCREASE IN
THE VALUE ADDED TAX.

7. COMMENT: THE FDP'S PROGRAM IS MORE CLEARLY ACCENTED
TOWARD TAX RELIEF FOR ALMOST EVERYONE (PLUS A DOLLOP TO
A FAST DECREASING MINORITY IN POPULATION-LOSING FRG).
RECENT ELECTORAL LOSSES AND LESS THAN ROSY PROSPECTS
ARE URGING THE FDP TOWARD AN ISSUE WHICH MIGHT SHARPEN
ITS IMAGE WITH THE ELECTORATE. THUS, ECONOMICS MINISTER
LAMBSDORFF (FDP) WAS QUICK TO THE DEFENSE OF THE
COUNCIL (BONN 11032) AFTER WORD LEAKED ABOUT THE
COUNCIL'S REPORT AND SOME SPD PARTY LEADERS LET OUT AN
ANGUISHED HOWL OF INDIGNATION.

8. CHANCELLOR SCHMIDT HAS REACTED RATHER
COYLY EXPRESSING SYMPATHY FOR TAX CHANGES WHILE CLAIMING
THAT FOR TECHNICAL REASONS THEY CANNOT BE IMPLEMENTED
AT THE BEGINNING OF 1979 (PROBABLY A PRETEXT FOR MAIN-
TAINING A FREE HAND ON THE ISSUE). AT THE SAME TIME,
HE HAS BEEN TRYING TO GUARD HIS LEFT FLANK BY LEAVING
OPEN THE POSSIBILITY FOR SOME SPECIFIC EXPENDITURE
INCREASES IN THE NEW BUDGET. FINESSING A COMPROMISE
ACCEPTABLE TO HIS PARTY'S DIRIGISTS AND TO THE FDP'S
FREE MARKETEERS WILL BE POSTPONED UNTIL AFTER AN ECONOMIC
SUMMIT WHICH COULD MAKE THE JOB EASIER, OR POSSIBLY MORE
DIFFICULT, DEPENDING ON WHAT THE CHANCELLOR HAS TO SHOW
IN THE WAY OF RESULTS.
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